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In the Supreme Court of the United States

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal,
Second Appellate District, State of California

Brief of the Appellee

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QUESTIONS PRESENTED

1. Should this Court now overrule *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, wherein this Court held that Congress had the power to, and in the McCarran-Ferguson Act did, completely release the states from all commerce clause restraints upon the regulation and taxation of interstate insurance business, and *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 (per curiam), wherein this Court applied the *Benjamin* holding to defeat a commerce clause challenge to a comparative insurance retaliatory tax which is substantially identical to the California retaliatory tax being challenged herein by appellant?

2. Is there any violation of the equal protection or due process guaranties of the United States Constitution by the application to appellant of the California comparative retaliatory insurance tax, which was enacted to secure uniformity and reciprocity among the states and which separately classifies each insurer by imposing upon said insurer the same higher tax burden (if any) as that insurer's home state would impose upon a similar California insurer?

3. Does the California holding that the constitutional validity of the gross premiums tax principal office deduction need not be determined in this case (because under California's insurance taxation structure any increase to appellants' gross premiums tax principal office deduction would automatically be balanced by an increase in its retaliatory tax liability) provide an adequate state ground which prevents this Court from having jurisdiction to consider appellant's challenge of the validity of the gross premiums tax principal office deduction?

4. If the retaliatory tax were held by this Court to be constitutionally invalid, then should the validity of the gross premiums tax principal office deduction (as amended in 1966

and repealed in 1976) be first determined on appeal by this Court without any remand to the California appellate courts; if so, was there any violation of the commerce clause or the equal protection or due process guaranties of the United States Constitution by the principal office deduction from the California gross premiums privilege tax, whereby some foreign (out-of-state) insurers did not get the same extent of the privilege tax deduction as their California counterparts?

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Brief of the Appellee

OPINIONS BELOW

The opinions below are correctly referenced by The Western and Southern Life Insurance Company (hereinafter "Western and Southern") on pages 1 and 2 of appellant's brief, except that the California Court of Appeal's opinion reported at 99 Cal.App.3d 410 and 159 Cal. Rptr. 539 is now reported with the November 28, 1979 modifications included. Also, in the Joint Appendix (J.A. 88-89) the bracketed references inserted in the Court of Appeal's order of November 28, 1979 are to pages in Western and Southern's jurisdictional statement rather than to the opinion as printed in the Joint Appendix.

GROUNDS FOR JURISDICTION

In its grounds for jurisdiction, Western and Southern incorrectly states (W. & S. 3)[1] that the California Court of Appeal expressly held that the principal office deduction provided by then article XIII, section 14-4/5(e) of the California Constitution and by California Revenue and Taxation Code section 12241 did not violate the United States Constitution. To the contrary, after finding the retaliatory tax to be constitutional, the Court of Appeal found it unnecessary to determine the constitutionality of the principal office deduction because of the interrelated nature of the California retaliatory and gross premiums taxes. J.A. 86-87, 89.

CONSTITUTIONAL AND STATUTORY PROVISIONS

With the exception of California Insurance Code sections 685.1 through 685.4, Western and Southern cites (W. & S. 4) the statutes and constitutional provisions which are involved in this case. However, its statutory appendix (W. & S. 1a-7a) contains several major errors as to the contents of the California constitutional provisions; therefore appellee State Board of Equalization is attaching its own statutory appendix (Appendix A) hereto in which the California provisions are properly set forth.

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1. Citations herein will be made in the following forms:
   (a) Brief for appellant Western and Southern: "W. & S."
   (b) *Amicus curiae* brief filed by the United States Solicitor General: "U.S."
   (c) *Amicus curiae* brief filed by the Life Insurance Council of New York (referred to herein as "LICONY"): "LICONY"
   (d) *Amicus curiae* brief for the State of New York: "N.Y."
   (e) Joint Appendix: "J.A."

STATEMENT OF THE CASE

This case involves the California tax provisions regarding insurance companies doing insurance business in California, including the California retaliatory tax for the years 1965 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. f(3) and Cal. Ins. Code §§ 685-685.4) and the principal office deduction from the California gross premiums tax for the years 1967 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. (e); former Cal. Rev. & Tax. Code § 12241). The California retaliatory tax provisions can be summarized as providing that when a foreign state would impose a heavier tax burden upon a California insurer than California would normally impose upon a similar insurer from that foreign state, then California will instead impose the same tax burden on that state's insurer as would be imposed by that state upon the similar California insurer. This is what is known as a "comparative" retaliatory tax; all of the 49 states which have retaliatory insurance tax statutes have comparative statutes. See below at p. 33 and Appendix B hereto.[2]

In determining appellant Western and Southern's retaliatory tax liabilities for each year in the case at bar, appellee State Board of Equalization (hereinafter "the Board") first determined the insurance premiums taxes and fees which Ohio (Western and Southern's home state) would have imposed on a similar California insurer transacting the same kind and amount of insurance business in Ohio that

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2. Before a 1964 amendment to the California constitutional provision, the California Constitution (but not the statute) had provided as an additional condition for the application of the retaliatory tax that the foreign state would actively discriminate by imposing upon the California insurer burdens exceeding those which it imposed upon its similar domestic insurer. *See Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 4-6, 62 Cal. Rptr. 784, 786-87 (hearing denied, Cal. Sup. Ct.)

Western and Southern actually transacted in California. Since the resulting Ohio figures were greater than the premiums taxes and fees owed by Western and Southern to California, the difference between those amounts was imposed as the California retaliatory tax under the terms of Insurance Code section 685 and California Constitution, article XIII, section 14-4/5, subdivision (f)(3) as amended in 1964.

California also imposes a gross premiums tax upon all insurers doing business in California; this is a privilege tax measured by the amount of gross premiums, less return premiums, received during the year by the insurer from its California business. During the years at issue said tax had a principal office deduction whereby an insurer could deduct from the premiums tax otherwise due the amount of certain real estate taxes which it had paid during the year upon real property containing its California principal office. Cal. Const., art. XIII, former § 14-4/5, subd. (e) as amended in 1966; Cal. Rev. & Tax. Code § 12241 as amended in 1967.[3] Western and Southern has challenged the constitutional validity of the principal office deduction for the years in issue on the basis of a distinction made therein between some California insurers and other insurers.

In the decision which is on appeal the California Court of Appeal, reversing a trial court decision (J.A. 55-79) in favor of Western and Southern, held that the California comparative retaliatory tax is constitutionally valid. J. A. 82-86. It further held that it did not need to reach the federal constitutional issues regarding the principal office deduction, for under California law the gross premiums tax and the retaliatory tax "are but parts of a single taxation

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3. The entire principal office deduction was repealed in 1976. See Appendix A for the text of the cited provisions.

scheme," wherein no tax refund is due unless the taxpayer has paid more than the total scheme required. J.A. 86-87, 89. Since the burden which Ohio would impose upon a similar California insurer would be greater than California's non-retaliatory tax burden on Western and Southern, any gross premiums tax reduction Western and Southern might gain on its principal office deduction issue would be offset automatically under California law by an increase in its retaliatory tax liabilities. *Id.* Because of this result under California law the Court of Appeal did not decide the principal office deduction issues raised by Western and Southern.

On December 27, 1979, the California Supreme Court denied Western and Southern's request for hearing in this case. J.A. 89.

SUMMARY OF ARGUMENT

It makes no difference in this case that the California laws now challenged by Western and Southern became effective after Western and Southern was given its California license for an indefinite term (which license was specifically conditioned upon conformance with present and future California laws). State laws must conform to the United States Constitution whether they are being applied to a corporation already doing business in the state or are imposed as a condition of entry or as a condition for a renewal of a license, for the Constitution is no longer construed as permitting states to require corporations to forfeit constitutional rights as a condition of being admitted to do business.

In *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, this Court held that Congress had the power to, and in the McCarran-Ferguson Act did, completely release the states from all commerce clause restraints upon the regulation and taxation of interstate insurance business, which this

Court had held in 1944 to be interstate commerce. In applying the McCarran-Ferguson Act the *Benjamin* holding specifically exempted from commerce clause restraints a state tax which this Court explicitly assumed to be discriminatory as to insurers from outside the taxing state. Congress has never indicated dissatisfaction with the *Benjamin* decision; recent decisions of this Court are fully supportive of its holdings.

In *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 this Court applied the *Benjamin* case in a *per curiam* opinion to uphold a Kansas comparative retaliatory insurance tax against an attack made in the name of the commerce clause. Since the Kansas statute was substantially identical to the California retaliatory tax being challenged by Western and Southern, the *Hobbs* decision, supported by the principles enunciated in *Benjamin,* applies here to defeat Western and Southern's commerce clause attack on the California retaliatory tax.

There is no equal protection violation arising from the application of the California retaliatory tax to Western and Southern. The retaliatory tax satisfies established equal protection standards by having valid legislative objects and by using a classification which is reasonably related to those legislative objects. *See Allied Stores of Ohio v. Bowers* (1959) 358 U.S. 522, 526-27. Any revenue raised by the retaliatory tax is purely incidental; objectives of the retaliatory tax are to foster the California insurance industry by encouraging evenhanded tax treatment by other states and to induce relative uniformity of state insurance tax burdens nationwide so as to encourage interstate insurance business. These purposes are advanced by classifying each insurer by the way its home state would treat a similar California insurer: the amount of the retaliatory tax as to each insurer is set and is reducible in a

purely reciprocal manner, depending on the current law of that insurer's home state; if that state would place a burden on a similar California insurer that is no greater than California's basic privilege tax burdens on the insurer in question, there is no California retaliatory tax due. This method of classification is fully consistent with this Court's equal protection decisions which allow greater burdens to be imposed on nonresidents if that classification rests on a reasonable basis other than just nonresidency *per se*. *See*, e.g., *Baldwin v. Montana Fish and Game Comm'n* (1978) 436 U.S. 371, 388-90; *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 810-14; *Metropolitan Co. v. Brownell* (1935) 294 U.S. 580, 582-86.

The purpose of the retaliatory tax law and its method of operation are supportive of any element of federalism within the equal protection clause, for the form of retaliatory tax adopted by almost every state encourages reciprocity between the states and results both in relatively uniform insurance tax burdens nationwide and in an effective restraint upon increases in those burdens. The California Legislature had and continues to have more than adequate support for the legislative assumptions which form the basis of the retaliatory tax law.

Given the validity of the retaliatory tax, the California Court of Appeal did not reach the issue of validity of the 1966 amendment to the principal office deduction which was a part of the California gross premiums privilege tax law until that deduction was repealed in 1976. The issue was not decided because under California law the gross premiums tax and the retaliatory tax are but interrelated parts of a single insurance taxation structure, so that any increase in Western and Southern's gross premiums tax principal office deduction would automatically be balanced

by an increase in its retaliatory tax liability. This basis forms an adequate and independent state ground which prevents this Court from having jurisdiction to consider appellant's challenge of the validity of the gross premiums tax principal office deduction. If this Court were to hold the retaliatory tax to be invalid, then this would be an appropriate case to remand to the California appellate courts for the first appellate determination of the validity of the principal office deduction. In any event, should this Court consider the principal office deduction issue, it is clear that the McCarran-Ferguson Act removes the possibility of commerce clause application and that the deduction, being part of a privilege tax law, did not violate equal protection standards by giving some foreign (out-of-state) insurers less of a deduction than their California counterparts. *See Cheney Bros. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 510-12, 514-15.

ARGUMENT

I. THE FACT THAT CALIFORNIA HAS GIVEN WESTERN AND SOUTHERN A LICENSE (WHICH WAS EXPRESSLY CONDITIONED ON CONFORMANCE WITH PRESENT AND FUTURE CALIFORNIA LAWS AND REQUIREMENTS) FOR AN INDEFINITE TERM DOES NOT AFFECT THE VALIDITY OF CALIFORNIA'S IMPOSITION OF THE TAX PROVISIONS INVOLVED IN THIS CASE.

Appellant Western and Southern and *amici curiae* in support of Western and Southern stress that California gave Western and Southern a license of an indefinite term before California reimposed its retaliatory tax in 1959 and before California amended its principal office deduction to the California gross premiums privilege tax. W. & S. 4, 8, 14-17, 33; U.S. 3, 9-10; LICONY 3, 6-7, 18; N.Y. 5. As recognized by Western and Southern (W. & S. 17),

the license itself (J.A. 43) was expressly conditioned upon Western and Southern's compliance with the California laws and lawful requirements as they then existed or might thereafter be changed or amended.

Appellee Board of Equalization does not claim that California has or ever had the power to impose unconstitutional conditions upon Western and Southern as a part of California's licensing process. Unless such a power existed at the time of admission, it makes absolutely no difference that California has given Western and Southern a license for an indefinite term.

Commerce clause considerations aside, now outdated nineteenth century authorities would provide clear support for the proposition that since a state can completely exclude a corporation, it can impose any conditions upon admission at the time of admission, even if those conditions would violate the Constitution if they were imposed after admission was granted to do business in the state. *See Pembina Mining Co. v. Pennsylvania* (1888) 125 U.S. 181, 188-90. However, in this century this Court has made clear the doctrine of unconstitutional conditions, whereby a corporation may *not* be required to give up its constitutional rights as a condition of admission to do business in a state. *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 83; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 507-08;[4]

4. Contrary to Western and Southern's characterization (W. & S. 15-16), the *Hanover Insurance Co.* opinion recognized that a state's power to impose conditions upon a corporation's *admission* was qualified by the requirement of the more modern decisions that the state's conditions could not require forfeiture of rights guaranteed by the United States Constitution. 272 U.S. at 507. *Hanover* was cited for this very point in *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 677, which is also cited by Western and Southern (W. & S. 17).

Power Co. v. Saunders (1927) 274 U.S. 490, 496-97; *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, 571.

Thus the nineteenth century approach no longer applies. *Southern Railway Co. v. Greene* (1910) 216 U.S. 400, which is relied upon by Western and Southern (W. & S. 8, 14-15) is but an example of the old line of cases which was rendered obsolete by such subsequent cases as those just cited above. A corporation may not be required to give up its constitutional rights as a condition of entry into a state. Except for the state's right to bar them completely, corporations seeking entry into a state stand on the same footing as corporations already authorized to do business therein.

It follows that, in the case at bar, if the California retaliatory tax as amended in 1964 and the principal office deduction as amended in 1966 could have been constitutionally applied to a foreign insurer[5] as conditions of being first admitted in 1967 to do business in California, they can be constitutionally applied to Western and Southern. Given the express conditions in Western and Southern's California certificate (J.A. 43) which make it clear that all constitutional amendments to California law will apply to Western and Southern, Western and Southern is in no better position in this case than if it were initially seeking application to do business in California or if it were applying for an annual renewal of its license.

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5. In this brief the term "foreign insurer" refers to an insurer domiciled in any state other than the taxing jurisdiction in question.

II. THE CALIFORNIA COMPARATIVE RETALIATORY TAX ON INSURERS IS CONSTITUTIONAL.

A. Due to the Federal McCarran-Ferguson Act, the California Insurance Retaliatory Tax Is Exempt from Commerce Clause Requirements; Said Tax Cannot Be Violative of Commerce Clause Requirements.

1. CONGRESS HAS THE POWER TO RELEASE ALL STATE TAXATION, DISCRIMINATORY OR NOT, OF INTERSTATE INSURANCE BUSINESS FROM COMMERCE CLAUSE RESTRAINTS.

In *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, this Court considered and forcefully rejected essentially the same argument that is now presented by appellant Western and Southern: that by the McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015) Congress could not and did not release all state taxation of insurance business from commerce clause restraints.[6] In *Benjamin* the Prudential Insurance Company argued that, no matter what Congress did or did not do, the commerce clause " 'of its own force' . . . forbids discriminatory state taxation of interstate commerce." *Id.* at 422. This Court rejected this contention and held to the contrary as follows:

> "The commerce clause is in no sense a limitation upon the power of Congress over interstate and foreign commerce. On the contrary, it is, as Marshall declared

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6. The McCarran-Ferguson Act was Congress' response to this Court's decision in *United States v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, which ended seventy-five years of precedent, starting with *Paul v. Virginia* (1869) 8 Wall. 168, in which insurance was held to not be interstate commerce and thus not subject to commerce clause restraints. The McCarran-Ferguson Act responded to a threatened breakdown of state insurance taxation and regulation which arose in the wake of *South-Eastern Underwriters. Group Life & Health Ins. Co. v. Royal Drug Co.* (1979) 440 U.S. 205, 217-19 & nn. 15-18.

> in *Gibbons v. Ogden,* a grant to Congress of plenary and supreme authority over those subjects. The only limitation it places upon Congress' power is in respect to what constitutes commerce, including whatever rightly may be found to affect it sufficiently to make congressional regulation necessary or appropriate." 328 U.S. at 423 (footnote omitted).

Thus Congress has the power to completely release the states from *all* commerce clause restraints upon the regulation and taxation of the interstate insurance business which this Court (in *United States v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533) had held to be interstate commerce.

2. IN THE McCARRAN-FERGUSON ACT CONGRESS EXERCISED ITS POWER TO RELEASE ALL STATE TAXATION OF INSURANCE BUSINESS FROM COMMERCE CLAUSE RESTRAINTS.

Contrary to the contentions of Western and Southern (W. & S. 27) and the Solicitor General (U.S. 17-18), in *Prudential Insurance Co. v. Benjamin* this Court held that in the McCarran-Ferguson Act Congress exercised its commerce clause power so as to free *all* state taxation, discriminatory or not, of insurance business from commerce clause attack. In *Benjamin* this Court was concerned with a South Carolina situation where a gross premiums tax was imposed on out-of-state insurers but *no* such tax was required of South Carolina insurers. *Id.* at 410-11. This Court made its decision on a stated *assumption* that the South Carolina tax was discriminatory against interstate commerce. 328 U.S. at 429.[7] Due to the clarity of the McCarran-

7. The Solicitor General fails to mention this stated assumption; instead the Solicitor General makes the misleading statement that "[i]t was not established that the South Carolina tax in issue was in fact discriminatory, and the Court refrained from addressing that question (*id* at 428)." U.S. 17.

Ferguson Act, this Court stated that it was "not necessary to spend much time with interpreting the McCarran Act." *Id.* After quoting the pertinent provisions,[8] this Court stated that "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Id.* As to the commerce clause, this Court, still operating under the assumption that it was dealing with a discriminatory tax, held that Congress in the McCarran-Ferguson Act

> "clearly put the *full weight of its power* behind existing and future state legislation to sustain it from *any* attack under the commerce clause to whatever extent this can be done with the force of that power behind it, subject only to the exceptions expressly provided for [in the act]." *Id.* at 431 (emphasis added).

It has already been established (above pp. 11-12) that said power of Congress was complete; it follows that *Prudential Ins. Co. v. Benjamin* is as clear as case authority can be that by the McCarran-Ferguson Act Congress exercised its power to release all state taxation, discriminatory or not, of insurance business from commerce clause restraints.

The contrary contentions of Western and Southern and the Solicitor General are easily answered. Contrary to the clear holdings of the *Benjamin* case, Western and Southern

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8. "'. . . the Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

'SEC. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

'(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .' 59 Stat. 33, 34; 15 U.S.C. §§ 1011-1015." *Id.* (footnote omitted).

claims (W. & S. 11-12, 27) that this Court indicated in *Benjamin* that its commerce clause holding did not necessarily exempt all state statutes regulating interstate insurance business from commerce clause attack; however, the passage relied upon by Western and Southern refers to the possible existence of state statutes that "may have been subject to serious question on the score of *other* constitutional limitations *in addition to* commerce clause objections arising in the *dormancy* of Congress' power." *Id.* at 430 (emphasis added). This statement was made in the context of the Court's recognition that Congress did not intend to circumvent constitutional limitations on its own power by attempting to validate every state regulation or tax as against all other types of constitutional attack; the statement is fully consistent with the holdings, recited above, that once Congress' power regarding the commerce clause was no longer dormant but had been exercised (as it was in the McCarran-Ferguson Act) so as to exempt all state regulation and taxation of interstate insurance business, there was no further restraint arising from the commerce clause to restrict state taxation of insurance business even when that taxation was discriminatory as to interstate commerce.[9]

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9. Western and Southern (W. & S. 26) and the Solicitor General (U.S. 17-18) also try to limit the *Benjamin* holding by referring to this Court's statement (*id.* at 431-32 n. 40) regarding certain statutes of other states. Footnote 40 of this Court's opinion cited statutes of sixteen other states which were "substantially similar" to the South Carolina tax. Apparently because this Court held that the South Carolina statute was consistent with other constitutional limitations as well as being immune from commerce clause attack (*id.* at 436, 437-38), this Court found it prudent to follow the citation of the sixteen other state statutes with a disclaimer "concerning the validity of any feature of the statutes not substantially identical with those of the South Carolina tax dealt with herein." *Id.* at 432 n. 40. That statement is consistent with the all-encompassing *Benjamin* holdings regarding the lack of *commerce clause* restraints on state taxation of insurance business after the enactment of the McCarran-Ferguson Act.

The Solicitor General tries to bring state retaliatory taxes on interstate insurance business out of the scope of the *Benjamin* decision by using such characterizations as "barriers of economic protectionism" (U.S. 16), "anticompetitive arrangements" (U.S. 16), and "statutory protectionism" (U.S. 18); the use of these labels cannot circumvent the fact that in *Benjamin* this Court clearly held that a state tax on insurance business that was discriminatory as to interstate commerce would be exempted by the McCarran-Ferguson Act from all commerce clause attack. For the same reason there is no basis for the Solicitor General's remark that there is no reason to construe the McCarran-Ferguson Act to permit "anti-competitive state taxation that discriminates against out-of-state insurers." U.S. 16.[10]

Given the commerce clause power of Congress and the broad scope of Congress' exercise of said power in the

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10. In making this remark the Solicitor General apparently means to refer to retaliatory taxes such as the one in issue. It should be pointed out that at the time of the McCarran-Ferguson Act retaliatory taxes had long been applied to insurance companies; in fact the constitutional validity of such a statute was before this Court in *Phila. Fire Association v. New York* (1886) 119 U.S. 110. See below at p. 21 n. 17. Thus the Solicitor General has no basis for his implied contention that taxes such as retaliatory taxes "had never been countenanced prior to the *South-Eastern Underwriters* decision . . . ." U.S. 16. Before *South-Eastern* there would have been no question under the commerce clause regarding the insurance taxation involved in this case; therefore appellee Board's position as to the commerce clause cannot be hurt by the Solicitor General's contention (U.S. 15-16) that the McCarran-Ferguson Act was only meant to reestablish what the state of the law had been before *South-Eastern* so as to remove the hazard to current state revenues. Also see W. & S. 28. Indeed, it is reported that after the *South-Eastern* decision fourteen states immediately repealed their retaliatory laws. Pelletier, "Insurance Retaliatory Laws", 39 Notre Dame Lawyer 243, 249 (1964). California was one such state; it repealed its retaliatory statute in 1945 (Cal. Stats. 1945, ch. 921, § 1, p. 1716) and enacted its current retaliatory statute in 1959 (Cal. Stats. 1959, ch. 2120, § 1, pp. 4945-46).

McCarran-Ferguson Act, it is not necessary here to discuss or decide whether the California insurance retaliatory tax would constitute a discriminatory tax under the commerce clause standards which would apply in the absence of the McCarran-Ferguson Act. Thus Western and Southern's reliance upon authorities (such as *Boston Stock Exchange v. State Tax Commission* (1977) 429 U.S. 318) involving the commerce clause as it exists outside the McCarran-Ferguson Act when Congress' power is still dormant (see W. & S. 12-13, 29-31) is reliance which is totally misplaced. The Prudential Insurance Company tried the same tactic in 1946, and this Court succinctly stated that such authorities were "not in point." 328 U.S. at 421.

Prudential Ins. Co. v. Benjamin was correctly decided in 1946, and nothing has occurred in the interim to diminish its standing as solid precedent.[11] Other courts have accepted its holdings without question.[12] In a case decided on June 9, 1980, this Court has just cited the *Benjamin* decision as illustrative of Congress' power to exempt the states from commerce clause restraints. *Lewis v. BT Investment Managers, Inc.* (1980) ..... U.S. ....., 48 U.S.L.W. 4638, 4643.[13] In 1979 this Court, after an independent survey of the

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11. The *Benjamin* holding that the exemption from commerce clause restraints provided by the McCarran-Ferguson Act extends to all taxation and regulation of interstate insurance business has not been questioned; it might be noted, however, that federal regulation of the insurance companies' relationships with their stockholders, not being part of the insurance business, are not affected by the McCarran-Ferguson Act. *SEC v. National Securities, Inc.* (1969) 393 U.S. 453, 458-61.

12. *See, e.g., Franklin Life Ins. Co. v. State Board of Equalization* (1965) 63 Cal.2d 222, 225 n. 2; 404 P.2d 477, 480 n. 2; *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 11-12, 62 Cal. Rptr. 784, 791.

13. The *amicus curiae* brief of the Solicitor General relies upon *Lewis* (U.S. 12) while ignoring that decision's recognition of Congress' broad power to exempt whole areas of the law from commerce clause coverage.

legislative history of the McCarran-Ferguson Act, echoed the holding of *Prudential v. Benjamin* in stating that the "primary concern" of Congress in the McCarran-Ferguson Act "was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance. . . . In short, the McCarran-Ferguson Act freed the States to continue to regulate and tax the business of insurance companies, in spite of the Commerce Clause." *Group Life & Health Ins. Co. v. Royal Drug Co.* (1979) 440 U.S. 205, 217-18 & n. 18, 219.[14] Finally, for more than thirty-four years Congress has indicated agreement with the landmark decision of *Prudential Ins. Co. v. Benjamin* by not passing any legislation that would have any adverse effect on the *Benjamin* case's interpretation of the McCarran-Ferguson Act. *See Canada Packers v. A., T. & S. F. R. Co.* (1966) 385 U.S. 182, 183-84.

Given this history, one must admire Western and Southern's courage in suggesting that, if appellant's strained and erroneous interpretation of the *Prudential Ins Co. v. Benjamin* decision is not accepted, then this Court now should abandon its prior decision.

3. THIS COURT APPLIED PRUDENTIAL INS. CO. V. BENJAMIN IN PRUDENTIAL INS. CO. V. HOBBS TO UPHOLD A KANSAS COMPARATIVE RETALIATORY TAX WHICH THE CALIFORNIA COURTS HAVE CORRECTLY RECOGNIZED AS BEING "SUBSTANTIALLY IDENTICAL" TO THE CALIFORNIA COMPARATIVE TAX CHALLENGED HEREIN.

As noted above, the *Prudential Ins. Co. v. Benjamin* decision established that even when a state tax on an out-of-

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14. The Solicitor General now argues (U.S. 15-16) that the congressional debate regarding the McCarran-Ferguson Act principally concerned antitrust legislation, with state taxation meriting only occasional brief references. In *Group Life & Health Ins. Co.* this Court held that the *secondary* purpose of the McCarran-Ferguson Act, after its primary purpose of allowing state regulation and taxation of the business of insurance companies free of *all* commerce clause restraint, was "to give insurance companies only a limited exemption from antitrust laws" *Id.*

state insurance company would be discriminatory so as to violate the commerce clause in absence of congressional action, the McCarran-Ferguson Act permits such a tax to be imposed without any commerce clause restraint. Thus even if, as claimed by Western and Southern and the Solicitor General, it is assumed that the comparative retaliatory insurance tax is anticompetitive and discriminatory against interstate commerce, this Court would need to do nothing more than to affirm its validity under the commerce clause with a *per curiam* opinion citing *Prudential Ins. Co. v. Benjamin.* In fact, this Court has already done just that, in *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 (*per curiam*).

The comparative retaliatory tax which was in issue in *Prudential Ins. Co. v. Hobbs* has previously been recognized as being "substantially identical to [California] Insurance Code section 685" (*Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 10, 62 Cal. Rptr. 784, 790), which is the precise statutory provision which has been applied (under the consistent California constitutional provision as amended in 1964) in the present case.

Hobbs involved several Kansas insurance taxes; one of the taxes involved was the Kansas retaliatory tax which was a purely "comparative" tax in that it required as a condition for its application that the foreign state impose a higher basic tax burden on Kansas insurers than Kansas imposed on that state's insurers, but it did not require that the other state have any internal domestic/foreign discrimination within its own laws to trigger the application of the Kansas retaliatory tax.[15]

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15. ". . . G.S. 1935, 40-253 provides that when the laws of a state under which the insurance company was incorporated require the payment of greater taxes, etc. from insurance companies of

Thus *Hobbs* did involve a state retaliatory insurance tax provision "substantially identical" to the California retaliatory tax as it exists at the present time and which the California Court of Appeal, citing *Hobbs* (J.A. 84, 89), has found to be constitutional. The Kansas Supreme Court in *Hobbs* found this retaliatory tax (and the other Kansas insurance taxes) to not be in violation of the commerce clause of the United States Constitution. *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 733, 735. This United States Supreme Court affirmed that holding in a *per curiam* decision, citing *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408.

By citing the *Benjamin* case in support of its affirmance of the constitutionality of the Kansas tax statutes in its *per curiam Hobbs* decision, this Court clearly held that each of those statutes were valid under the McCarran-Ferguson Act; if it did not (as Western and Southern argues), what was this Court's ruling as to the retaliatory tax in *Hobbs?* The Solicitor General (U.S. 17-18) joins Western and Southern (W. & S. 11-12, 26) in arguing that *Hobbs* cannot stand for more than *Benjamin,* thus contending by implication that this Court in affirming the Kansas decision somehow failed to pass upon the validity of the comparative retaliatory tax that was an integral part of the case before it. In other words, Western and Southern and the Solicitor

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other states than is required by the existing laws of this state, then such companies shall pay the taxes, etc. which would be required by a company organized in this state in order to do business in such other state." *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, *aff'd per curiam sub nom. Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822.

Given the nature of the retaliatory tax it is submitted that the statement quoted at the top of page 19 of LICONY's brief (and referred to at W. & S. 26-27) apparently was referring to one of the other Kansas taxes involved in *Hobbs.*

General argue that in 1946, one week after its *Benjamin* decision, this Court did not realize what it was doing when it made its *Hobbs* ruling.[16] Appellee State Board of Equalization believes it is clear that in *Hobbs* this Court meant to do just what it did: to apply the principles of the *Benjamin* case involving the McCarran-Ferguson Act in upholding the validity of a comparative retaliatory tax against an attack made in the name of the commerce clause.

Given the clarity of the McCarran-Ferguson Act and of this Court's decision in *Prudential Ins. Co. v. Benjamin,* and given the application of that decision in affirming (in *Prudential Ins. Co. v. Hobbs*) the validity of the Kansas retaliatory tax which was substantially identical to the California retaliatory tax now at issue, there can be no real question: the California Court of Appeal was correct in holding that the California comparative insurance retaliatory tax is valid when considered with reference to the commerce clause.

B. The Classification of Insurers Under the California Retaliatory Tax Rests on a Reasonable Basis and Is Consistent with Due Process and Equal Protection Guaranties.

1. INTRODUCTION

Both Western and Southern (W. & S. 14) and the trial court (J.A. 66) mention due process rights but fail to support their claims that Western and Southern's rights to due process of law have somehow been violated. Therefore, in this brief we shall assume that whatever due process

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16. Other *amici curiae* supporting Western and Southern tend to bypass the commerce clause issue. The State of New York never really deals with it, and LICONY merely adopts the Solicitor General's arguments (LICONY 4, 16). This lukewarm approach is understandable: in Hellerstein & Hellerstein, *State and Local Taxation* (4th ed. 1978) the author of the LICONY brief acknowledges that the McCarran-Ferguson Act "set aside *any* Commerce Clause barrier to State regulation of insurance" and that *Prudential Ins. Co. v. Benjamin* "upheld the constitutionality of the above Act as applied to taxes." *Id.* at 338 (emphasis added).

question which might exist would be concurrently resolved with the equal protection question of whether the distinctions or classifications inherent in the California insurance retaliatory tax have a rational basis.[17]

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17. As noted below (p. 45) the California gross premiums tax is a privilege tax, and as held by the California Court of Appeal (J.A. 87), the California retaliatory tax and the gross premiums tax "are but parts of a single taxation scheme." The LICONY *amicus* brief refers to the retaliatory tax itself as a privilege tax. LICONY 9. When the retaliatory tax is viewed as a privilege tax, there is no need to analyze further the Legislature's rational basis for the tax. *Phila. Fire Association v. New York* (1886) 119 U.S. 110, wherein this Court upheld the constitutionality of an insurance retaliatory tax against an equal protection claim, apparently was based on the now-obsolete theory (see above pp. 8-10) that a state could impose *any* conditions upon a corporation seeking entry, that only after entry would the corporation be a "person" entitled to the equal protection of the state's laws. Given the obsolete nature of the theory supporting the holding in *Phila. Fire Association*, no reliance now is placed by California on that case. However, in the more modern cases which recognize that all corporations are entitled to equal protection of the law, this Court has made it clear that, absent the special facts of *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (corporation with immense investments in property irretrievably devoted to a limited and monopolistic use), a state may constitutionally impose new *privilege* tax burdens on foreign corporations already doing business in the state without imposing equivalent burdens on domestic corporations. *Cheney Brothers Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 87-88; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 510-12, 514-15; *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 674, 675-78. Thus when the retaliatory tax is treated as a pure privilege tax, there is no need to go any further in determining a reasonable basis for the classification, for the *Southern Railway* case is distinguishable on its facts, and such cases as *WHYY v. Glassboro* (1968) 393 U.S. 117 (*per curiam*), *Reserve Life Insurance Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*) and *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, can be distinguished on the basis that they involved ad valorem property taxes. In any event, it is not necessary to rest wholly on the basis that the retaliatory tax is part of the California privilege tax on insurers. As will now be shown, the California Legislature had other clear and reasonable bases for making the retaliatory tax classifications.

2. THERE IS A PRESUMPTION, EXCEPTIONALLY STRONG UNDER THE SPECIAL FACTS OF THIS CASE, THAT CALIFORNIA'S INSURANCE TAX LAW IS CONSISTENT WITH THE CONSTITUTIONAL REQUIREMENT THAT THE LEGISLATURE HAD A LEGITIMATE PURPOSE AND A RATIONAL BASIS FOR THE CLASSIFICATIONS CONTAINED THEREIN.

It is a long standing rule that " 'in taxation, even more than in other fields, legislatures possess the greatest freedom in classification.' " *Lehnhausen v. Lake Shore Auto Parts Co.* (1973) 410 U.S. 356, 364. There is a presumption of constitutionality which gives rise to a burden on the one attacking the legislative arrangement " 'to negative every conceivable basis which might support it.' " *Id.* The wide breadth and outside limit of the state's taxing power with relation to the equal protection clause was summarized as follows in *Allied Stores of Ohio v. Bowers* (1959) 358 U.S. 522, 526-27:

> "The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to insure revenue and foster their local interests. Of course, the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value. [Citations.] 'To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure.' [Citation.]

> "But there is a point beyond which the State cannot go without violating the Equal Protection Clause. The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation.' [Citations.]"

In applying these standards in this case, due recognition should be given to the special status of state taxation of insurance corporations. First, being a corporation, Western and Southern is not a "citizen" who is entitled to rights under the privileges and immunities clause of the United States Constitution. *Asbury Hospital v. Cass County* (1945) 326 U.S. 207, 210-11; *Paul v. Virginia* (1869) 8 Wall. 168, 177. Second, as shown above, this case involves the business of insurance, a type of interstate commerce which Congress by the McCarran-Ferguson Act has left completely in the hands of the states insofar as removing all commerce clause restraint from the states as to its regulation and taxation. Thus this case presents a very purified equal protection issue which is outside of any influence of the interstate protections provided by the commerce clause or the privileges and immunities clause;[18] affirmance of the validity of the retaliatory tax as to Western and Southern does not mean that such a tax could be applied to individuals and corporations that are entitled to the protections of the commerce or privileges and immunities clauses.

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18. Therefore all reliance upon privileges and immunities cases (such as *Austin v. New Hampshire* (1975) 420 U.S. 656 (cited W. & S. 32, LICONY 14, N.Y. 5-6) and portions of *Toomer v. Witsell* (1948) 334 U.S. 385 (cited U.S. 10)) is misplaced, as is the Solicitor General's reliance (U.S. 10) on the commerce clause portions of *Toomer v. Witsell, id.*, and on *A&P Tea Co. v. Cottrell* (1976) 424 U.S. 366, another commerce clause case wherein this Court explicitly declined to consider an equal protection claim.

The McCarran-Ferguson Act has a further effect as to the application in this case of the equal protection clause of the Fourteenth Amendment. Although this Court has recognized that Congress was not empowered and did not intend to dispense with non-commerce clause constitutional rights of insurance companies (*Prudential Ins. Co.* v. *Benjamin,* 328 U.S. 408, 430), in interpreting the Fourteenth Amendment this Court has given great weight to the policy formulated by Congress in the McCarran-Ferguson Act as to insurance companies. *See State Bd. of Ins. v. Todd Shipyards* (1962) 370 U.S. 451.[19] As noted above, this Court in *Prudential v. Benjamin,* 328 U.S. 408, 437-38, held that the South Carolina privilege tax (which was only imposed on foreign insurers) did not deny equal protection. In *Benjamin* this Court also clearly indicated that, given Congress' action in exerting its power to exempt the states from all *commerce clause* restrictions as to regulation and taxation of insurance business, a markedly heavier burden applies to any insurance company which challenges state regulation or taxation under any *other* constitutional provision or provisions:

> "Clear and gross must be the evil which would nullify such an exertion, one which would arise only by exceeding beyond cavil some explicit and compelling limitation imposed by a constitutional provision or provisions designed and intended to outlaw the action taken entirely from our constitutional framework." *Id.* at 436.

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19. Contrary to LICONY's argument (LICONY 18), the Board does not agree (and has not stated) that the McCarran-Ferguson Act had absolutely no effect on the Fourteenth Amendment guaranties. *Todd Shipyards,* wherein this Court decided that several post-McCarran-Ferguson Act due process decisions would not be applicable to insurance companies, reveals the extent to which this Court has gone in giving effect to congressional policies espoused in the McCarran-Ferguson Act.

3. GIVEN THE SPECIAL CONTEXT OF THIS CASE, IT IS PARTICULARLY CLEAR THAT THE OBJECT AND THE CLASSIFICATION OF THE CALIFORNIA RETALIATORY TAX FULLY COMPLY WITH EQUAL PROTECTION REQUIREMENTS.

Not only do Western and Southern and its supporters fail to acknowledge the higher burden they face in the special context of this case; they do not even accept the challenge offered them by the general equal protection standards set forth so clearly in this Court's opinion in *Allied Stores v. Bowers,* quoted above. Instead they seek solace in the proposed standard which this Court declined to adopt in *Allied Stores,* and which accordingly appears in the *Allied Stores* concurring opinion. Said concurring opinion, which specifically drew a distinction between equal protection tax cases generally on the one hand and "ad valorem property tax" cases on the other, 358 U.S. at 532-33, proposed that in such ad valorem property tax cases the equal protection clause should be construed as having a significant bias *against* state distinctions which bear more heavily on out-of-state businesses. *Id.*

Western and Southern and its supporters would take this proposed standard outside of its own designated ad valorem property tax context and apply it to the retaliatory tax. In apparent recognition that a bias *in favor* of certain classes of business (those from out-of-state) has no place in a constitutional provision which guarantees *equal* protection, this Court has not adopted any such bias in its equal protection decisions. While it is clear that differences in residency *per se* do not normally provide a rational basis for classification,[20] it is also clear that the mere fact that

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20. *See, e.g., Herndon v. Chi., Rock Island & Pac. Ry.* (1910) 218 U.S. 135, 158-59; *Power Co. v. Saunders* (1927) 274 U.S. 490, 493-94; *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, 572 (discussed in detail below at pp. 39-41); *Reserve Life Ins. Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*); *WHYY v. Glassboro* (1968) 393 U.S. 117, 120 (*per curiam*), all relied upon by Western and Southern. Although *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (also relied upon by Western and Southern) has been

heavier burdens are placed on nonresidents as compared to residents does not determine that there is an equal protection violation. In addition to privilege tax situations (see above p. 21 n. 17), this Court has long upheld heavier burdens on nonresidents as long as more than mere nonresidency is present to justify the classification, even though the justification may arise because of the difference in residences. *See, e.g., Baldwin v. Montana Fish and Game Comm'n* (1978) 436 U.S. 371, 388-90 (substantially higher hunting license fees on nonresidents); *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 810-14 (substantially heavier burdens of documentation on out-of-state scrap processors); *Metropolitan Co. v. Brownell* (1935) 294 U.S. 580, 582-86 (imposition only upon foreign businesses of a three-year minimum on contractual limitations for insureds' suits against the insurers). In each of these cases this Court has proceeded on the basis that a state's application of heavier burdens upon nonresident corporations or individuals does not deny equal protection as long as the classification has a basis which is rationally related to a proper purpose of the statute.[21] This is exactly the same standard which was applied by this Court in *Allied Stores* in upholding a state statute which placed greater burdens on *domestic* businesses: "That a statute may discriminate in favor of a certain class does not render it arbitrary if the discrimination is founded upon a reasonable distinction, or difference in state policy." *Allied Stores v. Bowers,* 358 U.S. at 528 (see further quotation above at pp. 22-23).

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limited to its facts with regard to any continuing effect as a privilege tax case (see below p. 47), it is also distinguishable from the current issue on the basis that the classification in *Southern Railway* rested solely on the basis of different residences.

21. This line of United States Supreme Court cases is directly contrary to the language of the District Court in *Western Union Telegraph Co. v. Frear* (W.D. Wis. 1914) 216 Fed. 199, which is heavily relied upon by Western and Southern (W. & S. 9, 18).

When applying the equal protection standards set by this Court in the above cases, the case at bar is quite simple. One of the California Legislature's bases for enacting the California insurance retaliatory tax was to benefit its domestic insurers by encouraging foreign states to provide treatment for those California insurers which was as favorable as the tax burdens California was imposing on foreign insurers.[22] Fostering the domestic California insurance industry by encouraging evenhanded tax treatment of California insurers certainly is a proper interest of the State of California; the only remaining equal protection test is whether the classification made has a reasonable relation to the object of the legislation. Contrary to the claims of Western and Southern (W. & S. 21) and the Solicitor General (U.S. 10), the classification challenged here was not made solely on the basis that Western and Southern was from a state other than California. The California comparative retaliatory tax does not classify all out-of-state insurers together and impose greater burdens upon such insurers as a group; rather, the statute separately classifies each insurer by the way that insurer's home state would treat a similar insurer from the state having the retaliatory statute.[23] It is only when the insurer's home state would impose a greater aggregate burden on a California insurer with the same characteristics that California will subject the foreign insurer to the California

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22. See *Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal.App.3d 21, 34.

23. In upholding the equal protection validity of the pre-1964 California retaliatory tax, *Franklin Life Ins. Co v. State Board of Equalization* (1965) 63 Cal.2d 222, 232-33, 404 P.2d 477, 485, demonstrated that such a comparative test does not even classify all insurers from the same state together; given the aggregate nature of the test in satisfying the intent behind the statutes, some insurers from one state may be subject to the tax while others from the same state with different characteristics are not.

retaliatory tax. Thus the class subject to the tax is exactly limited to those insurers whose home states are susceptible to pressure to lower their burdens to the California level.[24]

The California retaliatory tax fully satisfies the equal protection standard as stated and applied by this Court through the years and as quoted above at pp. 22-23. Its conformance to that standard is particularly clear when the case is viewed in the special context of state taxation of insurance corporations after the enactment of the McCarran-Ferguson Act; in that context a statute regulating or taxing interstate insurance business must be a "clear and gross evil exceeding beyond cavil" some "explicit and compelling" constitutional limitation before it can possibly constitute a violation of a constitutional provision such as the equal protection clause. See above, p. 24.

4. THERE WAS AND IS A RATIONAL BASIS FOR THE CALIFORNIA RETALIATORY TAX WHICH FULLY REFLECTS ANY AND ALL ELEMENTS OF FEDERALISM WITHIN THE EQUAL PROTECTION CLAUSE.

The California comparative retaliatory tax is still valid if the equal protection clause in the context of this case has the extra element of federalism suggested in the concurring opinion in *Allied Stores*. The first object of the California tax mentioned above is not to extract extra revenues from foreign insurance companies[25] but to achieve tax bur-

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24. Western and Southern argues (W. & S. 17-20) that to be valid the classification must be based on differences between the entities being classified *other than* differences having to do with different home states. This is not so; for example, in *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, a discrimination against out-of-state scrap processors whose manners of operations were assumed to be identical to domestic processors was held to be a reasonable classification under equal protection standards. *Id.* at 811. As indicated above at pp. 25-26, support for valid classifications may arise *because* of the different residences, even though different residences *per se* could not alone satisfy the rational basis test under the equal protection clause.

25. Any increase in revenue to California due to the retaliatory tax is incidental. *See Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal.App.3d 21, 34, 84 Cal. Rptr. 88, 96, and Ohio and Washington cases cited therein.

dens in other states for California insurers which are equal to or less than California's general (nonretaliatory) burden on all insurers; if that objective were completely achieved the retaliatory tax would no longer be collected at all due to equalization of the basic tax burdens. But the objective behind the retaliatory tax is broader than that: As pointed out by the California Court of Appeal (J.A. 82-83), the more general purpose of retaliatory taxes is "to put pressure on the several states to impose the same tax burden on all insurance companies" and thereby "encourage the doing of interstate business." As phrased in *Atlantic Insurance Co. v. State Board of Equalization* (1967) 255 Cal. App.2d at 15, 62 Cal. Rptr. at 793, citing *Bankers Life Co. v. Richardson* (1923) 192 Cal. 113, 124, 218 Pac. 586, 591, retaliatory insurance tax laws are enacted to "secure reciprocity" and "to achieve uniformity of treatment and not to discriminate." In fact, such laws are intended to discourage any state from imposing discriminatory burdens upon out-of-state insurance companies. *Id.* at 4; 62 Cal. Rptr. at 786.[26]

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26. The following examples demonstrate how these objectives are achieved by a comparative retaliatory tax. Assume that state A levies a relatively heavy tax burden on all insurers. If states B, C, and D have lower insurance tax burdens and no comparative retaliatory taxes, the economies of states B, C, and D, through payment of high state A taxes by their domiciliary insurers, will be generating disproportionate tax revenue support to state A, while state A's insurers enjoy the lesser burdens in states B, C, and D. If states B, C, and D enact comparative retaliatory taxes, state A's insurers will find themselves paying high burdens everywhere; they will thus bring great pressure on state A to adjust its insurance tax burdens down to the lower levels of states B, C, and D. Once those levels are matched, no further retaliatory taxes will be collected although the retaliatory tax statutes remain on the statute books.

The purely comparative retaliatory statutes of states B, C, and D would have the same equalizing tendencies had state A originally discriminated within its own tax laws so as to impose a lesser burden on its domestic insurers than it imposed on insurers from states B, C, and D. Assume that state A imposed the same burden upon its own domestic insurers as states B, C, and D imposed upon

Other states have upheld the validity of their comparative insurance retaliatory tax laws and have recognized the common purposes of equalizing tax burdens and preventing discrimination. In *Phoenix Ins. Co. v. Welch* (1883) 29 Kan. 672, 32 Pac. States Rep. 480, the Kansas Supreme Court found the Kansas comparative retaliatory provision to be more "a provision of reciprocity":

> "It is, in brief, an appeal for comity; a demand for equality. As such, it is manifestly fair and just. It arouses no sense of injustice, and simply says to every other state in the Union: 'We will meet you on the basis of equality and comity, and will treat you as you treat us.'" *Id.* at 675, 32 Pac. States Rep. at 482.[27]

The Kansas Supreme Court then held the retaliatory provision to be consistent with the Kansas Constitution's principle of equality of taxation; the Kansas holding would be equally appropriate here:

> "The legislature may classify for the purposes of taxation or license, and when the classification is in its nature not arbitrary, but just and fair, there can be no constitutional objection to it.... Here foreign insurance corporations are classified by the states from which they come, and, when we consider the purposes of such classification, it cannot be held that there is anything arbitrary or unjust therein." *Id.* at 678, 32 Pac. States Rep. at 484-85.

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all insurers, but that state A imposed a discriminatory higher burden upon all insurers from outside state A. Under the comparative retaliatory taxes states B, C, and D would increase their burden so as to impose the same tax burden on state A's insurers as the higher burden which state A imposed on insurers from states B, C, and D. The resulting pressure on state A would be to end its internal discrimination and lower its taxes on out-of-state insurers to match the normal (non-retaliatory) burdens imposed upon all insurers by states B, C, and D.

27. *See also, Indemnity Ins. Co. of North America v. Stowell* (1961) 172 Ohio St. 167, 174 N.E.2d 536; 539; *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, *aff'd sub nom. Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822; *Pacific*

Accord: Baldwin v. Insurance Co. North America (1888) 115 Ind. 257, 17 N.E. 574, 579. The validity of the Pennsylvania comparative retaliatory tax was upheld in *Commonwealth v. Fireman's Fund Ins. Co.* (1952) 369 Pa. 560, 87 A. 2d 255, wherein the Pennsylvania Supreme Court also declared that the purpose of the retaliatory tax is not to raise revenue but "to bring about equality of treatment between domestic and foreign corporations and to break down interstate barriers." *Id.* at 258.

This broader purpose behind retaliatory insurance tax statutes is particularly appropriate in the post-McCarran-Ferguson Act context, where the states can tax the interstate commerce of insurance without any of the normal restraints of the commerce clause. The retaliatory statutes of the states themselves serve as a partial substitute for the commerce clause, encouraging states to recognize the advantages of common trade between the several states by maintaining relative uniformity of state insurance tax burdens. Due to the fact that the insurance tax system is composed of the statutes of the individual states, the retaliatory tax also fosters the interstate commerce of insurance by tending to keep insurance tax rates from increasing at the same pace as other state taxes, even in these times when the states are experiencing increasing revenue pressures. Any one state which raised its tax burden above the other states' burdens would be jeopardizing its own insurance industry by causing it to be subject to retaliatory taxes in the other states. Thus, using the words of the *Allied Stores* concurring opinion, the objectives and

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Mut. Life Ins. Co. v. State (1931) 161 Wash. 135, 296 Pac. 813, 814-15. Some states (Alabama, Idaho, Kentucky, Wyoming) include in their comparative retaliatory statutes statements designating the purpose of the statute as being protection against "discriminatory or onerous requirements" under the laws of other states. Citations to the retaliatory insurance statutes of the various states are included in Appendix B attached hereto.

structure of the retaliatory tax serve to "adjust[ ] the demands of individual States to . . . tax these enterprises in light of the multistate nature of our federation." 358 U.S. at 532. The overall thrust of the retaliatory tax is fully reflective of any element of federalism which is contained in the equal protection clause.

5. THE LOGICAL LEGISLATIVE ASSUMPTIONS SUPPORTING THE CALIFORNIA RETALIATORY TAX ARE SUPPORTED, NOT REFUTED, BY THE FACTS.

This Court has very recently restated the following rule:

> "In an equal protection case of this type . . . those challenging the legislative judgment must convince the court that the legislative facts on which the classification is apparently based could not reasonably be conceived to be true by the governmental decisionmaker. [Citations.]" *Vance v. Bradley* (1979) 440 U.S. 93, 111.

In the *Vance* case this Court rejected a challenge to a mandatory retirement age of 60 for foreign service employees. The challengers had presented empirical evidence against such a requirement and argued that the government was required to offer "current empirical proof" to support the legislative classification. In reply, this Court quoted *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 812, in stating that " '[t]he State is not compelled to verify logical assumptions with statistical evidence.' " 440 U.S. at 110 n. 28. The *Vance* decision concludes that if the facts are even "arguable" the legislative classification will be immunized from constitutional attack. *Id.* at 112.

The amicus brief of LICONY attempts and fails to surmount this extremely high burden of proof. The truth is that a look at the real world tends to corroborate the logical assumptions (set forth above) as to the operation of the retaliatory tax on insurers.

One quite important fact is the near universality of insurance retaliatory statutes among the states. Forty-nine of the fifty states have comparative retaliatory statutes in their statute books, and apparently 48 of those 49 comparative retaliatory taxes are collected whenever their terms permit.[28] So far as is known, even New York, whose attorney general is challenging the constitutional validity of the California retaliatory statute as *amicus curiae* for Western and Southern herein, is still more than happy to collect any retaliatory taxes which might become due under the New York comparative retaliatory statute. N.Y. Ins. Law § 61. Thus 96% of the states apparently are collecting comparative retaliatory insurance taxes whenever their statutory conditions are satisfied. This near universality of the retaliatory statute gives considerable force to the legislative assumptions behind the California retaliatory tax. A state which wishes to increase its insurance tax burdens to a high level has to worry about more than just California's law; it must consider the nation-wide impact upon its own insurance industry that any such increase might have.[29]

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28. A list of these statutes is appended hereto as Appendix B. Hawaii has no retaliatory tax law pertaining to insurance business. The insurance retaliatory laws of New Mexico are upon insurance brokers and insurance agents respectively and not directly upon insurance companies. Appellee is informed that North Carolina has exercised statutory discretion and does not actually collect the comparative retaliatory taxes provided for in section 58-152 of the North Carolina General Statutes; thus potential conflict with N.C. Gen. Stat. § 105-228.8 need not be resolved.

29. New York provides an example of the type of pressures experienced by a state which attempts to fight the federalistic restraints of the retaliatory tax system. As detailed in footnote 1 of the LICONY brief (LICONY 2-3) New York has attempted to break out of the retaliatory tax pattern by imposing tax burdens with a relatively high ceiling of 2.6% of taxable premiums; however, in its quest for more tax revenues, New York has experienced an exodus of domestic companies from New York (N.Y. 3) and has felt the brunt of the retaliatory tax system to such an extent

As noted above (p. 29), one of the objectives of the retaliatory taxes is to obtain uniformity of treatment; LICONY argues (LICONY 19-22) that this objective is not borne out by actual facts. However, using LICONY's own figures in its Appendix B regarding taxation of out-of-state life insurers, it can be seen that twenty-six states share the same exact tax rate of 2%, with none below 1% and only three states (Hawaii (3.197%), Oklahoma (4%), and Texas (3.3%)) above 3%. Furthermore, the differences in the inner workings of the basic insurance taxes which LICONY complains of on pages 20 and 21 of its brief are rendered irrelevant by the aggregate nature of application of California's comparative retaliatory tax. In determining under the aggregate method whether the retaliatory tax will apply, the *total burden* that would be imposed upon a similar California insurer for doing business under the foreign state's law is compared with the *total burden* for doing business imposed by California upon the foreign insurer. *See Bankers Life Co. v. Richardson* (1923) 192 Cal. 113, 122-25, 218 Pac. 586, 590-91.[30] Thus the California re-

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that it now grants a *credit* to its domestic companies for 90% of any retaliatory taxes they are required to pay to other states. N.Y. Tax Law § 1511(c). This 90% credit, whereby New York indirectly pays the retaliatory taxes of the New York insurers, gives rise to the question as to the true extent of the interest of the members of the Life Insurance Council of New York (LICONY) in this matter. In its brief LICONY fails to note that if the retaliatory tax were held to be invalid, LICONY'S members would lose the benefits of their current favored position (due to the 90% credit) under New York law, and they would be subjected to whatever further rate increases that New York is anxious to impose but has not because of the retaliatory tax system. It also can be reasonably assumed that soon after any abolishment of the retaliatory tax, the members of LICONY would find themselves paying more in increased basic premiums taxes in other states than they are now paying in retaliatory taxes.

30. Since California has adopted the aggregate method, the "item by item" method illustrated on page 21, note 8 of LICONY's brief is not at issue here. In any event, LICONY itself reports (LICONY App. C, p. 8a) that only four states have administered their statutes by utilizing the "item-by-item" method.

taliatory tax is concerned with uniformity of treatment with regard to equalizing total tax burdens as between similar insurers in the several states; it is not concerned with making every aspect of every state insurance statute identical. Certainly under the standards stated in *Vance v. Bradley, supra,* a legislature could reasonably conceive as true the proposition that, at a time when retaliatory taxes are almost universal among the states, the basic tax burdens imposed by those states tend toward uniformity.

What of the secondary thrust of the retaliatory tax; does it tend to keep the general level of insurance tax burdens from increasing? In 1964 it was reported that "the tax on premiums has stayed close to two percent in most states." Pelletier, "Insurance Retaliatory Laws," 39 Notre Dame Lawyer 243, 247. The current facts drawn from LICONY's appendix B and set forth above as to taxes on foreign life insurance companies could be summarized by exactly the same statement, even though fourteen years of great tax expansion in other areas have passed in the interim. LICONY's own quoted authority (Bodily, "The Effects of Retaliation on the State Taxation of Life Insurers," 44 J. of Risk & Insurance 21 (1977) (cited LICONY 22-23)) reports that life insurance rates "have increased little since the assumed low starting rate of 1935." *Id.* at 30. That author merely believes that retaliatory provisions have not been the cause of the low rates, although he recognizes that the contrary conclusion is "theoretically possible." *Id.* at 34, quoted LICONY 22. Such possibility is sufficient to satisfy the standards for constitutionality under *Vance v. Bradley,* where this Court held that "the very admission that the facts are arguable . . . immunizes from constitutional attack the congressional judgment represented by this statute." 440 U.S. at 112.

LICONY's other cited authorities recognize the effectiveness of the retaliatory tax system. Strickler, "The Mess in State Premium Taxation of Insurance Companies," vol. 69, nos. 9 and 10, Best's Review (Property/Liability Ins. Ed.) 34 (1969) (quoted LICONY 24-25), forthrightly states that "[t]he dominant result [of the retaliatory tax system] is a dampening effect on out-of-staters' tax bites . . ." (*id.* at 38). Similarly, the reason given by the New Jersey Tax Policy Committee (see LICONY 25) for the recommended abolishment of the retaliatory tax system (by the federal Congress, not unilaterally by New Jersey) was that the system works too *well*: "retaliatory insurance taxes virtually preclude any increase in this State's level of insurance taxes." Report of the New Jersey Tax Policy Committee, Part V, 47, 48, 50 (1972).[31]

The logical assumptions that retaliatory taxes encourage uniformity of tax burdens and retard general increases in those insurance tax burdens are also corroborated by the very presence of the broad and national representation of the insurance industry as *amici curiae in support of the California State Board of Equalization's position* in this case in defense of the retaliatory tax; the national insurance industry (including members from New York) would not be supporting this tax on insurers if the current retaliatory tax system were not to the industry's benefit; its conclusion regarding the benefit to the insurance industry of a universal system of retaliatory tax laws is supported by such authorities as Felton, "Retaliatory Insurance Company Taxation," 38 J. of Insurance 71, 80 (1961).

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31. Similar concerns may have contributed to the statement emanating from the National Association of Insurance Commissioners, which statement is quoted on page 24 of LICONY's brief. In any event, the elimination of retaliatory insurance taxes was recommended within the N.A.I.C. as only one part of "a single and indivisible program". 1 Proc. Nat'l Ass'n of Insurance Comm'rs 69, 71 (1971).

It is respectfully submitted that, under the standards set forth in *Vance v. Bradley* (1979) 440 U.S. 93, 110-12, the California Legislature had and continues to have a more than adequate basis for believing that the classification scheme set forth in the California comparative retaliatory tax statute will promote the constitutionally permissible goals of the statute.

6. OTHER CONTENTIONS MADE IN SUPPORT OF WESTERN AND SOUTHERN'S EQUAL PROTECTION ATTACK ON THE RETALIATORY TAX ARE WITHOUT MERIT.

a. Statutory reference to laws of other states is permissible.

As shown above, the application of the California retaliatory tax involves reference to the laws of the insurer's home state to compare burdens in determining what, if any, retaliatory tax is due. If retaliatory taxes are due under the California law, the out-of-state insurer presumably will pressure its home state to lower to California levels its own tax burdens on California companies.[32] If such a lowering occurs, automatic reciprocation causes the California retaliatory tax to be reduced to zero as to the foreign state's insurer. Such references to other state laws and tax reductions according to their content do not violate the Fourteenth Amendment. *See Bode v. Barrett* (1953) 344 U.S. 583, 586.

LICONY would distinguish (LICONY 10-14) the California retaliatory tax from other reciprocity statutes (such as the one involved in *Bode v. Barrett, id.*) wherein tax exemptions are provided to a nonresident if his home state grants similar exemptions to the taxing state's residents.

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32. At the least, the retaliatory tax will give the insurer a forceful argument against any *increases* in its home state's tax burdens on California insurers.

LICONY's proposed ground for distinction (LICONY 13) appears to be that if the basic tax levy is valid and no exemptions are required, then the state can impose any discriminatory method it wants regarding any credits or exemptions it chooses to provide. This approach could cause very pernicious results; it clearly is inconsistent with the reasoning behind the doctrine of unconstitutional conditions set forth above (pp. 8-10), whereby a state may exclude a corporation completely but cannot condition entry on forfeiture of constitutional rights of the corporation.

Western and Southern (W. & S. 32) and its supporters (U.S. 10, LICONY 14, N.Y. 5-6) all attempt to draw support from privileges and immunities cases such as *Austin v. New Hampshire* (1975) 420 U.S. 656 (and, in the brief of the United States, a commerce clause case, *A & P Tea Co. v. Cottrell* (1976) 424 U.S. 366), in arguing that the California tax's involvement with other states' laws and its attempt at influencing said laws somehow result in a violation of the equal protection clause. It is submitted that those cases do not apply in determining the equal protection issue presented here. The Board relies on the merits of the arguments made above in application of equal protection standards (pp. 25-31), on *Bode v. Barrett, supra,* and on the following statement from *U.S. Steel Corp. v. Multistate Tax Comm'n* (1978) 434 U.S. 452, 478:

> "Any time a State adopts a fiscal or administrative policy that affects the programs of a sister State, pressure to modify those programs may result. Unless that pressure transgresses the bounds of the Commerce Clause or the Privileges and Immunities Clause of Art. IV, § 2, *see, e.g., Austin v. New Hampshire,* 420 U.S. 656 (1975), it is not clear how our federal structure is implicated."

b. The great contrast between the California retaliatory insurance tax and the Ohio tax in Wheeling Steel Corp. v. Glander tends to confirm the constitutionality of the California tax.

Western and Southern relies heavily upon *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562. In reality, a close reading of *Wheeling Steel* is helpful in demonstrating why the insurance retaliatory taxes now at issue are truly reciprocal while the Ohio *ad valorem* tax involved in *Wheeling Steel* was not.

In *Wheeling Steel* Ohio attempted to impose an *ad valorem* tax on accounts receivable from sales resulting in the shipping of a commodity from an Ohio manufacturing plant, even though the seller resided outside of Ohio and the sales had occurred outside of Ohio. Ohio tried to validate this tax by providing that other states could tax Ohio residents in a similar fashion. The *Wheeling Steel* excerpts quoted by Western and Southern (W. & S. 21-22) provide the following grounds for holding that tax to be a violation of equal protection:

1. The *taxpayers* would get no benefit from the so-called reciprocity.[33] If other states accepted Ohio's offer to tax Ohio residents similarly, the Wheeling Steel Corporation would still be stuck with the entire Ohio tax, whereas in the current case if Western and Southern's home state (again Ohio) decided to reduce its insurance tax to the California level, Western and Southern would be relieved of *all* California retaliatory tax.[34]

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33. In the words of this Court, "It is hard to see that this offer of reciprocity restores to appellants [taxpayers] any of the equality which the application of the Ohio tax, considered alone, so obviously denies." 337 U.S. at 573.

34. This aspect of the retaliatory tax arises from its classification of each insurer individually on the basis of how its home state would treat a similar insurer domiciled in California (see above pp. 27-28). This classification is quite different from putting all out-of-state corporations in one class, as was attempted in cases cited on pages 17 through 19 of Western and Southern's brief.

2. In the four years between the enactment of the Ohio *ad valorem* tax and this Court's decision in *Wheeling Steel,* other states had not indicated any readiness "to copy Ohio's situs scheme". 337 U.S. at 573, 574. In contrast, in the case at bar, almost every state has a comparative insurance retaliatory tax. See above p. 33 and Appendix B.

3. The Ohio scheme was not "an even bargain between states." *Id.* at 573. In contrast to the long history and widespread enactment of state insurance retaliatory taxes, Ohio had obviously concocted a new tax scheme which would only benefit states with Ohio's special characteristics. Thus there was not much prospect for many other states to accept Ohio's offer in the future.

4. Even if other states accepted Ohio's purported "reciprocal" offer, "the equality of rates which would also be necessary to equalize the burden between non-residents and their resident competitors could be hardly expected nor is it provided for." *Id.* at 574. In *Wheeling Steel* Ohio was merely offering other states the opportunity to tax Ohio residents; as noted by the Court, there was no provision to equalize tax *rates.* In fact, the Ohio plan might well have led to an escalation of tax rates by the states upon each other's residents. In contrast, as noted in *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 4, 15 and as discussed above (pp. 34-36) the common purposes of insurance retaliatory taxes of encouraging reciprocity and avoiding discriminatory burdens have been realized by keeping insurance taxes close to 2 percent in most states.

In conclusion, *Wheeling Steel* does not conflict with the Board's discussion (above at pp. 28-37) of the truly reciprocal nature of California's retaliatory insurance tax. If anything, the *Wheeling Steel* decision provides a contrast which

only makes clearer the constitutional validity of the retaliatory tax at issue here.[35]

c. The possibility of alternative methods does not affect the validity of the tax in issue.

Western and Southern and its supporters present the Court with alternative types of retaliatory taxes which California might choose (see W. & S. 31, LICONY 22, N.Y. 2-3). Most would not aid the accomplishment of the purposes behind the retaliatory tax;[36] however, one suggestion (LICONY 22) is that California could carry the reciprocal element of the tax further by applying to each foreign insurer the same burden that its home state would apply to a California insurer, even when that burden was *lower* than the basic California gross premiums burden. While this procedure would be consistent with the retaliatory tax purposes, it could create other problems.[37] In any event,

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35. LICONY argues (LICONY 9-10) that the *Wheeling Steel* decision stands for the proposition that reciprocity cannot justify initial discrimination. *Wheeling Steel* stands for the opposite proposition. In *Wheeling Steel* this Court closely examined the claimed reciprocity and found that no true reciprocity existed. Presumably, since the Court felt that the reciprocity claims "require[d] scrutiny", *id.* at 572, if Ohio had provided true reciprocity it would have had a definite bearing on the constitutionality of the Ohio taxes.

36. For example, it has been shown above (pp. 29-30 n. 26) that California's current purely comparative tax combats anti-foreign insurer discrimination by other states just as effectively as the pre-1964 California tax which Western and Southern now claims "bore a semblance of justification" (W. & S. 31). New York's "reciprocal exemption" provision (N.Y. 2-3) is meant to be a step toward a defeat of the goals of the retaliatory tax system, not a step toward attainment of those goals.

37. For example, the California Legislature might balk at such a rule as being unwise because of a legislative desire to preserve the current status of the state's fiscal structure so that at least some certain minimum amount can be expected as revenues from the basic gross premiums tax. Also, the Legislature simply might desire to retain uniformity of its retaliatory statute with the form adopted by most other states.

any possibility that the California Legislature could have furthered the underlying purpose of the retaliatory tax more completely does not make the method it chose unconstitutional. *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 813. As shown in the above discussion, the legislative purposes behind the California insurance retaliatory tax statute are proper, and the classification made by that statute is rationally related to those proper purposes. Under the equal protection standards provided by the authorities cited above at pages 22-26, the California retaliatory tax as applied to Western and Southern is valid.

III. ONCE THE RETALIATORY TAX IS HELD TO BE CONSTITUTIONAL, THERE IS AN ADEQUATE STATE GROUND THAT RESULTS IN THERE BEING NO JURISDICTION IN THIS COURT TO DECIDE THE FEDERAL ISSUE REGARDING THE PRINCIPAL OFFICE DEDUCTION: THE CALIFORNIA COURTS HAVE DETERMINED SOLELY ON THE BASIS OF CALIFORNIA LAW THAT, GIVEN THE VALIDITY, APPLICATION AND FUNCTION OF THE RETALIATORY TAX AS ONE PART OF A CONSOLIDATED SCHEME OF CALIFORNIA INSURANCE TAXATION, IT IS UNNECESSARY TO DECIDE WESTERN AND SOUTHERN'S CHALLENGE OF THE VALIDITY OF THE GROSS PREMIUMS TAX PRINCIPAL OFFICE DEDUCTION.

Mixed in with Western and Southern's argument concerning the retaliatory tax is a challenge by Western and Southern of the constitutional validity of a 1966 amendment to the principal office deduction which used to be provided as part of the California gross premiums tax law. The entire principal office deduction (including the challenged 1966 provision) was repealed in 1976.

As the California Court of Appeal has held in the instant case (J.A. 86-87, 89), once the constitutional validity of the California retaliatory tax has been established, there is no need to determine the constitutional validity of the 1966

principal office deduction amendment on the merits, for the holding that the retaliatory tax is valid fully determines that Western and Southern is not entitled to any judgment on its suit for tax refund: any lowering of Western and Southern's California premiums tax liabilities for each year would result under California law in an identical increase in the retaliatory tax amount, so that Western and Southern's liabilities under the two taxes would still total the same as the total insurance tax liability an identical California insurer would incur in Ohio, Western and Southern's home state.[38] This outcome under the retaliatory tax results from the fact that Ohio imposed or would have imposed a greater tax burden on a similar California insurer than California imposed on Western and Southern for the years involved.

The California holding in this case, that as a matter of California law the retaliatory tax and the gross premiums tax "are but parts of a single taxation scheme" wherein no refund is due unless the taxpayer has paid more than the entire scheme required (J.A. 87, 89), is a construction of the California statutes and constitutional provisions which is binding upon this Court. *See Hebert v. Louisiana* (1926) 272 U.S. 312, 316. Furthermore, the California resolution of the principal office deduction issue on this basis constitutes an adequate state ground independent of the federal issue, not decided by the Court of Appeal, of whether the post-1966 principal office deduction to the California gross premiums tax taken by itself would have violated the constitutional rights of a foreign insurer. Given the presence of such an adequate independent state ground in the case at bar, this Court has no jurisdiction in this case over the

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38. The trial court noted the same interdependence in the minute order it issued with its memorandum of intended decision. J.A. 56.

issue of the constitutional validity of the post-1966 principal office deduction. *Herb v. Pitcairn* (1945) 324 U.S. 117, 123-24, 125-26.

IV. IF THE RETALIATORY TAX WERE HELD TO BE UNCONSTITUTIONAL, THIS WOULD THEN BE AN APPROPRIATE CASE TO REMAND TO THE CALIFORNIA APPELLATE COURTS FOR A DETERMINATION REGARDING THE VALIDITY OF THE PRINCIPAL OFFICE DEDUCTION.

When appeal is made to this Court from a state court in a case involving a constitutional challenge to the validity of a state statute, this Court's appellate jurisdiction rests on the state court's decision being "in favor of its validity." 28 U.S.C. § 1257(2). As already noted, the validity of the now-repealed principal office deduction has not been passed upon by the California Court of Appeal or the California Supreme Court. If the retaliatory tax were held by this Court to be unconstitutional, the otherwise substantial and adequate state ground stated above at pp. 42-43 would cease to exist, for it is clearly conditioned on the continued validity of the retaliatory tax. However, there can be no question that the California Court of Appeal's ruling on the principal office deduction was made on the basis of a good faith belief in the constitutionality of the retaliatory tax.

Under these conditions this Court might well have the power to treat the California decision as if it indeed had upheld the constitutional validity of the principal office deduction, even though no such holding occurred. *Cf., Lawrence v. State Tax Comm.* (1932) 286 U.S. 276, 282-283. But such action would deprive the California Court of Appeal and the California Supreme Court of a fair chance to consider the principal office deduction issue in light of any holding of this Court of unconstitutionality regarding the retaliatory tax.

There is an additional consideration. In both the trial court and the Court of Appeal Western and Southern argued in its briefs that the principal office deduction (and the retaliatory tax) violated separate provisions of the California Constitution which Western and Southern characterized as providing "generally equivalent but independent protection" comparable to the federal Constitution.[39] Thus, there is some possibility that the California appellate courts, if faced with the issue regarding the validity of the principal office deduction, might decide that issue based on the California Constitution rather than the United States Constitution.

Under these circumstances it is respectfully submitted that, if the retaliatory tax were to be held invalid by this Court, then this would be an appropriate case to remand to the California appellate courts for determination of the validity of the principal office deduction as provided by California law until the 1976 repeal. *See Cardinale v. Louisiana* (1969) 394 U.S. 437, 438-39.

V. THE 1966 AMENDMENT TO THE PRINCIPAL OFFICE DEDUCTION FROM THE CALIFORNIA PRIVILEGE TAX ON INSURERS WAS CONSTITUTIONALLY VALID.

The California gross premiums tax is the basic insurance tax which is imposed on all insurers in California; it is measured by gross premiums (less return premiums) received on insurance business done in California, and is clearly a *privilege* tax, not a property tax. *Carpenter v. Peoples Mut. Life Ins. Co.* (1937) 10 Cal.2d 299, 302, 74 P.2d 508, 510. Until 1976 California had provided for a deduction (the principal office deduction) from this privi-

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39. There is no question but that Western and Southern also argued the federal constitutional grounds it continues to present in its brief in this Court.

lege tax for certain real estate taxes paid regarding the insurer's California real property wherein its principal office in California was located. Western and Southern challenges the validity of a 1966 amendment whereby Western and Southern, because of the proportion (ranging from 76% to about 78%) of its California office building which was occupied by tenants other than Western and Southern, was allowed less of a deduction that it would have been allowed had it been a California insurance company with the same characteristics. See App. A, pp. 5-7. The entire principal office deduction was repealed for all insurers in 1976.

All of the principles that sustain the validity of the 1966 amendment to the privilege tax deduction have been stated earlier in this brief. Citations to those portions of this brief will avoid unnecessary repetition. It makes no difference that the 1966 amendment occurred after Western and Southern had received a California license for an indefinite term (which license was expressly conditioned upon conformance with present and future California laws). See above pp. 8-10. Due to the McCarran-Ferguson Act there can be no violation here of the commerce clause. See above pp. 11-17. Finally and most significantly, when dealing (as here) with a *privilege* tax in a situation without the special facts of *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (see next paragraph), this Court has firmly established that a state does not violate equal protection rights of foreign corporations already doing business in the state by imposing new *privilege* tax burdens on them without also imposing equivalent burdens on domestic corporations. See above p. 21 n. 17, citing *Cheney Brothers Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 87-88; *Hanover Ins. Co. v.*

Harding (1926) 272 U.S. 494, 510-12, 514-15; *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 674, 675-78.[40]

Some further comments as to the privilege tax point are in order here. Western and Southern relies heavily on *Southern Railway Co. v. Greene* (1910) 216 U.S. 400; that case is not applicable here. First, that case's approach has been rejected by later cases which establish the doctrine of unconstitutional conditions. See above pp. 8-10. Second, even though *Southern Railway* did involve a privilege tax, later cases have strictly limited the holding in that case to its specific facts (immense investments in property only suitable for the taxpayer's particular use), facts which are distinguishable from a general use office building such as Western and Southern's. *Baltic Mining Co. v Massachusetts* (1913) 231 U.S. 68, 87-88; *Cheney Bros. Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Northwestern Life Ins. Co. v. Wisconsin* (1918) 247 U.S. 132, 140. Thus Southern *Railway Co. v. Greene* clearly does not apply in this case. It is just as clear that the ad valorem *property* tax cases relied upon by Western and Southern (such as *WHYY*

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40. *Hanover and Lincoln Life* both involved states which provided for the issuance of annual licenses. 272 U.S. at 503, 508, 509; 325 U.S. at 675. In *Lincoln Life* great stress was made (*id.* at 676) of the fact that the Kansas license to do business was (like California's in the present case) expressly conditioned on compliance with subsequently enacted laws. The *Lincoln Life* decision distinguished such licenses from "unequivocal" licenses, and cited *Hanover* as an "unequivocal" license case (*id.*); thus by mistakenly treating annual renewals as the determinative factor as to whether licenses were "unequivocal", the California Court in the portion of the *Atlantic* decision quoted at LICONY 7-8 n. 3 misconstrued *Lincoln Life* while correctly holding that the pre-1964 California retaliatory tax did not violate equal protection rights. In addition to the above cases involving higher privilege taxes on *foreign* corporations, in *Northwestern Life Ins. Co. v. Wisconsin* (1918) 247 U.S. 132 this Court held to be valid a privilege tax where higher burdens were placed on *domestic* insurers. Unrelated portions of the *Baltic Mining Co.* decision were disapproved in *Alpha Cement Co. v. Massachusetts*, 268 U.S. 203, 218 (1925). Similarly, the portions of *Cheney Bros.* relied upon above were unaffected by *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274 (see LICONY 15 n. 5).

v. Glassboro (1968) 393 U.S. 117 (*per curiam*); *Reserve Life Insurance Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*) and *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562) have no application in this privilege tax context.[41]

CONCLUSION

The shadow of Western and Southern's commerce clause argument fades to nothingness in the clear light of the McCarran-Ferguson Act as powerfully focused by this Court's decisions. As to equal protection rights, Western and Southern's attack on the privilege tax principal office deduction is repelled by the accumulated strength of this Court's line of decisions upholding state *privilege* tax burdens even when they are placed more heavily upon out-of-state corporations after their admission to do business. Although there have been no recent decisions of this Court which specifically uphold an insurance retaliatory tax against an attack based on equal protection claims, the equal protection standards forged and applied by this Court in other cases apply here to establish the constitutional validity of the California retaliatory insurance tax, whether or not it is treated as a privilege tax.

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41. Both sides in the current case rely upon *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494. It is true that this Court in *Hanover* found one Illinois tax (which Illinois in *Hanover Fire Ins. Co. v. Harding* (1927) 327 Ill. 590, 158 N.E. 849, 854 acknowledged was a property tax) to be invalidly applied to foreign insurers. 272 U.S. at 515-16. However, this Court *upheld* the validity of another Illinois tax that was a gross premiums *privilege* tax which Illinois had imposed in 1919 *only* on foreign insurers. 272 U.S. at 503-04, 510-11, 512, 514-15. The taxpayer had already been admitted to do business in Illinois when the 1919 tax was enacted. See *Hanover* Transcript of Record, October Term 1926, docket No. 179, pp. 32, 44; *Hanover Fire Ins. Co. v. Carr* (1925) 317 Ill. 366, 148 N.E. 23, 24. By the different treatment accorded the two types of taxes in *Hanover*, *Hanover* serves to emphasize the distinction between *privilege* tax cases (such as the current case) and *property* tax cases (such as the cases relied upon by Western and Southern).

For the reasons given above it is respectfully submitted that the decision of the California Court of Appeal should be affirmed.

Dated: December 18, 1980.

Respectfully submitted,

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(Appendices Follow)

Appendix A

California Constitutional and Statutory Provisions

Retaliatory Tax:

Article XIII, section 14-4/5, subdivision (f)(3), as amended in 1964 and as it was in effect for the years 1965 through 1971, provided as follows: '

> (3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or

country within the meaning of this paragraph (3) of subdivision (f).

The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

California Insurance Code sections 685 through 685.4, as enacted in 1959, and as they have existed without change ever since, provide as follows:

§ 685.

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit re-

quirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article.

§ 685.1.

This article shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or

personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this article.

§ 685.2.

For the purposes of this article the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States. In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

§ 685.3.

To the extent permitted by the Constitution of this State there is hereby imposed upon the commissioner the duty of enforcing the execution of the provisions of Section 685. It shall be the duty of the commissioner to initiate the enforcement and execution of the provisions of Section 685 in request to all matters which by the Constitution or laws of this State require further or final action by other officials of this State. In respect to any matter initiated by the commissioner, it shall be the duty of the Board of Equalization, Board of Control and State Controller to complete the enforcement and execution of the provisions of Section 685 in respect to such matter within the scope of the duties and powers of each as set forth in the Constitution and laws of this State.

§ 685.4.

The provisions of this article shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

Gross Premiums Tax, Principal Office Deduction:

Article XIII, section 14-4/5, subdivision (e), as amended in 1964 and as it was in effect for the years 1967 through 1971, provided as follows:

> (e) (1) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.
>
> (2) In the event a portion of the real property described in paragraph (1) of this subdivision is occupied by a person or persons other than the insurer the deduction granted the insurer by said paragraph shall be limited to that percentage, not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January

1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this paragraph, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(3) The phrase "person or persons other than the insurer" as used in paragraph (2) of this subdivision shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities. The Legislature may define the terms used in this paragraph for the sole purpose of facilitating the operation of this paragraph.

California Revenue and Taxation Code section 12241, as amended in 1967 and as it was in effect for the years 1967 through 1971, provided as follows:

§ 12241.

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(b) In the event a portion of the real property described in subdivision (a) is occupied by a person or persons other than the insurer the deduction granted the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities.

Appendix B

The following are all the state statutes which provide for a retaliatory tax; all are "comparative" retaliatory statutes:

Code of Ala. 1975 § 27-3-29 (1977); Alaska Stat. § 21.09.270 (1966); Ariz. Rev. Stat. § 20-230 (1977); Ark. Stat. § 66-2225 (1961); Cal. Ins. Code §§ 685-685.4 (1959); Colo. Rev. Stat. 1973 § 10-3-209(2) (1973); Conn. Gen. Stat. § 12-211 (1965); Del. Code Ann. tit. 18, § 531 (1953); Fla. Stat. Ann. § 624.429 (1969); Ga. Code Ann. § 56-321 (1960); Idaho Code § 41-340 (1961); Ill. Ins. Code § 444 (Smith Hurd Ill. Ann. Stat. ch. 73, § 1056) (1941); Indiana Code § 27-1-20-12 (1937); Iowa Code Ann. § 505.14 (1955); Kan. Stat. Ann. § 40-253 (1967); Ky. Rev. Stat. Ann. § 304.3-270 (1970); La. Rev. Stat. § 22:1079 (1970); Me. Rev. Stat. Ann. § 24-A-428 (1973); Md. Ann. Code art. 48A, § 61 (1971); Mass. Ann. Laws ch. 175, § 159 (1922); Mich. Stat. Ann. § 24.1476 (1948); Minn. Stats. Ann. § 60A.19, subd. 6 (1971); Miss. Code §§ 27-15-121 through 27-15-127 (1964); Mo. Ann. Stat. § 375.916 (1967); Mont. Rev. Code § 40-2826 (1959); Neb. Rev. Stat. § 44-150 (1959); Nev. Rev. Stat. § 680A.330 (1971); N. H. Rev. Stat. § 400-A:35 (1971); N.J. Stat. Ann. § 17:32-15 (1950), § 17B:23-5 (1971); N.M. Stat. § 59-5-36 (1978) (insurance brokers), § 59-5-57 (1978) (insurance agents); N.Y. Ins. Law § 61 (1973); N.C. Gen. Stat. § 58-152 (1945); N.D. Century Code § 26-01-05 (1943); Ohio Rev. Code Ann. § 3905.41 (1953), § 5729.06 (1953); Okla. Stat. Ann. tit. 36, § 628 (1957); Ore. Rev. Stat. § 731.854 (1967); 40 Pa. Cons. Stat. Ann. § 50 (1974); R.I. Gen. Laws § 27-2-17 (1956); Code of Laws of S.C. § 38-5-480 (1976); S.D. Cod. Laws § 58-6-70 (1978); Tenn. Code Ann. § 56-4-218 (1979); Vernon's Ann.

Texas Stat., Ins. Code art. 21.46 (1957); Utah. Code Ann. 31-14-9 (1963), Vt. Stat. Ann. tit. 8, § 3367 (1967); Va. Code § 38.1-87 (1952); Wash. Rev. Code Ann. § 48.14.040 (1947); W. Va. Code Ann. § 33-3-16 (1957); Wis. Stat. Ann. § 76.66 (1979), § 76.67 (1979); Wyo. Stat. § 26.1-77 (1967).

The years given with the above citations show the date of enactment or date of most recent amendment or reenactment.